

INDEPENDENT AUDITORS' REPORT

Superintendent
City of Seattle - City Light Department
Seattle, Washington

We have audited the accompanying balance sheets of the City of Seattle - City Light Department (the "Department") as of December 31, 2003 and 2002, and the related statements of revenues, expenses, and changes in equity and of cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of December 31, 2003 and 2002, and the changes of its equity and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, during 2003, the Department changed its method of presenting certain power sale and purchase transactions related to the adoption of Emerging Issues Task Force ("EITF") Issue No. 03-11, *Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not "Held for Trading Purposes" as Defined in EITF Issue No. 02-03*.

The management's discussion and analysis on pages 18 through 25 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Deloitte & Touche LLP

Deloitte & Touche LLP
Seattle, Washington
May 21, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS - DECEMBER 31, 2003

The following discussion and analysis of the financial performance of the City of Seattle - City Light Department (the "Department") provides a summary of the financial activities for the year ended December 31, 2003. This discussion and analysis should be read in combination with the Department's financial statements, which immediately follow this section.

RESULTS OF OPERATIONS

Condensed Revenues and Expenses

Year ended December 31,	2003	2002
Operating revenues	\$739,005,298	\$697,892,243
Nonoperating revenues	3,849,386	10,467,972
Total revenues	742,854,684	708,360,215
Operating expenses	700,067,504	639,136,563
Nonoperating expenses	77,054,688	84,057,713
Total expenses	777,122,192	723,194,276
Capital contributions	22,089,096	10,631,017
Grants	4,044,558	2,337,759
Net loss	\$ (8,133,854)	\$ (1,865,285)

Net Loss—The Department recorded a net loss of \$8.1 million in 2003, an increase of \$6.2 million from the \$1.9 million loss experienced in 2002. Expenses in both 2002 and 2003 included the amortization of \$100 million in power costs deferred from 2001. Without these noncash charges, net income would have been \$98.1 million in 2002 and \$91.9 million in 2003.

Water conditions in the Northwest region were again below normal in 2003, depressing the Department's wholesale revenues relative to the expected levels. Operating revenues increased by \$41.1 million from 2002 to 2003, but certain elements of this increase were offset by corresponding increases in operating expenses, which were \$60.9 million above the 2002 level. Net nonoperating expenses were virtually unchanged from the prior year. Contributions and grants totaled \$26.1 million in 2003, a doubling of the amount realized in 2002.

OPERATING REVENUES

Operating revenues totaled \$739.0 million in 2003, an increase of \$41.1 million (5.9%) from the level of \$697.9 million recorded in the prior year. Revenue from retail sales were \$10.2 million lower than in 2002, with the decline concentrated in the residential sector.

Wholesale revenues were \$49.3 million higher than in 2003, but the increase was partially offset by corresponding increases in the cost of wholesale purchases. Other revenues increased by \$2.0 million, from \$13.0 million in 2002 to \$15.0 million in 2003.

Retail Revenues—Revenue of \$552.2 million from retail power sales within the Department's service territory was 1.8% lower than the \$562.4 million realized in 2002. Revenue from residential customers totaled \$199.1 million, a reduction of \$12.9 million (6.1%) from the prior year. The drop in residential revenue reflects a decrease of 4.3% in energy consumption in the residential class and a reduction of 1.9% in the average rate billed. Temperatures in the first quarter of 2003 were higher than in the corresponding period of 2002, which had the effect of reducing consumption for residential space heating. Reductions in consumption are more likely to occur in the higher-priced second and third residential rate blocks, thus lowering the average rate paid. In addition, effective June 14, 2002, the Seattle City Council reduced the residential third-block rate and increased the consumption threshold at which the third-block rate began to apply. Revenue from commercial customers increased by \$5.3 million (2.2%), while industrial revenue showed an offsetting reduction of \$5.5 million (8.7%). Revenue from governmental customers increased by \$0.5 million (1.0%). Estimated unbilled revenue increased by \$2.4 million from year-end 2002 to 2003, reflecting the fact that temperatures in November and December 2003 were lower than in the same period of 2002. Retail revenues were also reduced by a one-time noncash charge of \$3.7 million needed to correct an overstatement of retail revenue in prior periods that was identified in 2003.

Wholesale Revenues—Revenue from short-term wholesale power sales was \$137.7 million, an increase of \$35.6 million (34.8%) from the prior year. The increase in revenue from 2002 to 2003 is attributable to an increase in the price at which wholesale energy was sold, from

an average of \$24.27 per megawatt hour (“MWh”) in 2002 to \$37.29 per MWh in 2003. The amount of wholesale energy sold actually decreased by 8.3%, from 4,647,945 MWh in 2002 to 4,262,041 MWh in 2003. Revenue from wholesale sales, net of the cost of wholesale purchases, totaled \$113.4 million in 2003, an increase of \$23.8 million from the \$89.6 million in net revenue realized in 2002.

Other Power-Related Revenue—The Department derives revenue from a number of other power-related activities, including the delivery of power under seasonal exchanges, the sale of capacity, the sale of conservation savings to the Bonneville Power Administration (“Bonneville”), and the sale of transmission basis services. Revenues from these activities increased from \$20.4 million in 2002 to \$34.1 million in 2003, an increase of \$13.7 million (67.2%). The increase in revenue associated with the delivery of energy under basis transactions was equal to the entire net variance in this category of revenues, \$13.7 million. However, there were variances in other elements of this category that tended to offset one another. Revenue from the sale of wheeling service to other utilities increased by \$2.0 million from 2002 to 2003. The sale of reserves to other purchasers of the Bonneville Slice product, an activity that was initiated in October 2003, added \$1.4 million to revenues. Other power-related transactions added an additional \$1.4 million. Offsetting these increases was a reduction of \$2.0 million in the valuation of energy delivered by the Department under exchange agreements, which largely reflected the termination of an exchange agreement with Idaho Power; a decrease of \$1.1 million in rental payments from Bonneville for the use of transmission facilities; and a decrease of \$1.0 million in revenue from integration and exchange services provided by the Department in connection with wind generation.

Other (Miscellaneous) Revenues—Other revenues increased from \$13.0 million in 2002 to \$15.0 million in 2003, an increase of \$2.0 million (15.8%). Late fees and interest charges on delinquent accounts increased by \$1.5 million, from \$3.9 million in 2002 to \$5.4 million in 2003. Revenue from the rental of transmission towers to telecommunications companies for antenna attachments generated an increase of \$0.5 million in revenue. Settlement of a claim related to the performance of turbine runners installed at the Boundary

Project provided \$1.2 million in additional revenue. Revenue from these sources was offset by net decreases in property rentals, damage recoveries, and other sources totaling \$1.2 million.

OPERATING EXPENSES

Operating expenses in 2003 totaled \$700.1 million, an increase of \$60.9 million (9.5%) from the prior year. Power and transmission costs account for \$43.2 million of this increase. Other operations and maintenance costs showed an increase of \$13.5 million. Smaller increases were recorded in depreciation and taxes.

Long-Term Purchased Power—The cost of energy purchased from other utilities through long-term contracts increased from \$222.9 million in 2002 to \$240.5 million in 2003, an increase of \$17.6 million (7.9%).

Bonneville Power Administration (“Bonneville”)—The cost of power purchased from Bonneville increased by \$22.3 million, from \$134.8 million in 2002 to \$157.1 million in 2003. The Department’s contract with Bonneville provides for purchases of energy in two forms. First, the Department purchases a fixed block of energy in amounts shaped to its net monthly power requirements at rates set through Bonneville’s rate-setting processes. Second, the Department purchases a product commonly known as the “Slice of the System”, which entitles the Department to receive 4.6676% of the output of the Federal Columbia River Power System and which requires the Department to pay the same percentage of the costs of the system. The contract also provides for after-the-fact true-up payments to reconcile actual costs with the projected costs on which billings are based. The true-up payment of \$10.4 million was deferred at the end of 2002 to be amortized over the period from April 1, 2003, through February 29, 2004, and in 2003, the Department recorded an amortization expense of \$8.6 million. A true-up credit for 2003 of \$6.3 million was deferred at the end of 2003, and will be recognized during 2004. In 2002, the Department elected to reduce its Slice entitlement in return for a reduction of \$14.7 million in its Slice bills. No such reduction occurred in 2003. Other true-up adjustments added \$2.3 million to the cost of Bonneville power in 2003. The cost of energy purchased as a block was \$1.8 million higher in 2003 than

in the preceding year. These increases were offset by reductions in the rates charged for the Slice product in 2003, which lowered costs by \$5.1 million relative to 2002. The amount of energy received from Bonneville in 2003 was 4,713,124 MWh, slightly higher than the 4,659,586 MWh received in 2002.

Wind Generation—The cost of power purchased from the State Line Wind Project, located in Walla Walla County, Washington, and Umatilla County, Oregon, increased from \$6.5 million in 2002 to \$11.3 million in 2003. Costs include the cost of integration and exchange services required to deliver energy from the project as a constant amount across all hours. The increase in costs reflects a doubling of the energy received from wind generation, from 106,493 MWh in 2002 to 216,290 MWh in 2003.

Klamath Falls—Expenses related to the Department's contract for power from the Klamath Falls Cogeneration Project fell from \$39.7 million in 2002 to \$36.3 million in 2003, a reduction of \$3.4 million (8.6%). Total fuel costs were \$21.8 million in 2003 compared to \$25.2 million in 2002, reflecting decreases in the average cost of fuel during 2003. Energy delivered from Klamath Falls to the Department in 2003 totaled 654,502 MWh, a reduction of 55,018 MWh (7.8%) from the 2002 level. The Department elected to take power from the plant in only nine months in 2003, compared to 10 months in 2002.

Grand Coulee Project Hydroelectric Authority—The Department contracts for 50% of the output of a series of small hydroelectric projects operated by irrigation districts in the Columbia Basin in Central Washington. In 2003, the Department's share of the cost of power from these projects was \$4.8 million, a decrease of \$2.5 million (34.0%) from the 2002 level. Debt service costs fell by \$0.5 million. An increase of \$1.3 million in incentive payments to the irrigation districts in 2003 was offset by the fact that a true-up payment of \$3.4 million in 2002 related to past incentive payments was not repeated in 2003.

Seasonal Exchanges—Expenses associated with the receipt of power under seasonal exchange agreements were \$3.1 million lower in 2003 than in 2002. An exchange agreement with Idaho Power terminated

on October 31, 2002, and was not renewed; power valued at \$1.4 million was delivered to the Department in 2002 under this agreement. The blended weighted average cost of power, which is used to value power delivered and received under the exchange agreements, increased from 2002 to 2003 in the months in which power is received under an exchange agreement with Tacoma Power, resulting in an increase in the cost of long-term purchased power of \$0.4 million. In the months in which energy is received under an agreement with the Northern California Power Authority the blended weighted average cost of power declined, resulting in a reduction of \$2.1 million in expenses from 2002 to 2003. (The net reduction of \$3.1 million in seasonal exchange expenses is offset by the \$2.0 million reduction in seasonal exchange revenues discussed above, providing an increase in net revenues of \$1.1 million from the valuation of seasonal power exchanges.)

Other Power Contracts—The cost of power delivered to the Department under contracts with Pend Oreille County PUD No. 1 and Grant County PUD No. 1 increased by \$0.2 million and \$0.3 million, respectively. Payment to King County Metro for power from Metro's cogeneration facility at the West Point Sewage Treatment Project were \$0.2 million lower than in 2002.

Amortization of Deferred Power Costs—In both 2002 and 2003, \$100 million in power costs deferred from 2001 were amortized. The remaining \$100 million of deferred power costs from 2001 will be amortized in 2004.

Short-Term Wholesale Power Purchases—The cost of short-term purchases of energy in the wholesale market increased from \$12.4 million in 2002 to \$24.2 million in 2003, an increase of \$11.8 million (94.8%). The increase reflects both an increase in the amounts purchased (from 898,613 MWh in 2002 to 1,210,699 MWh in 2003) and an increase in the average price of the purchases (from \$25.77 per MWh in 2002 to \$37.61 per MWh in 2003).

Other Wholesale Power Transactions—Expenses related to other power-related transactions increased from \$1.9 million in 2002 to \$13.9 million in 2003, an increase of \$12.0 million. Virtually all of

this increase is attributable to the purchase component of basis transactions with counterparties, which increased from \$1.3 million to \$13.4 million. When both the sale and purchase components of these transactions are taken into account, net revenue of \$2.5 million was recognized in 2003, compared to \$0.9 million in 2002.

Other Power Costs—The cost of operating the Department’s System Control Center and other power-related costs increased from \$6.3 million in 2002 to \$7.3 million in 2003. Data processing costs at the Control Center account for most of the increase.

Generation—Costs associated with the operation and maintenance of the Department’s hydroelectric generating plants increased from \$18.5 million in 2002 to \$20.2 million in 2003, an increase of \$1.7 million (9.0%). Increases in the payments to the Federal Energy Regulatory Commission (“FERC”) for fees, and to other regional utilities for upstream benefits, contributed to the increase in generation expenses.

Transmission—Transmission costs, including the cost of wheeling power over the facilities of BPA and other utilities, totaled \$34.5 million in 2003, a reduction of \$0.9 million (2.4%) from the level of \$35.4 million recorded in 2002. The cost of operating and maintaining transmission facilities owned by the Department increased from \$4.3 million to \$4.4 million. Wheeling costs fell from \$31.1 million in 2002 to \$30.1 million in 2003, largely as a result of a reduction in the amount paid to Idaho Power Company for transmission of power from the Lucky Peak project. Prior to October 1, 2002, the Department contracted with Idaho Power to transmit Lucky Peak power to the point of delivery under an exchange agreement with Idaho Power. When the exchange agreement terminated on October 1, 2002, the Department contracted to sell Lucky Peak energy to another counterparty with delivery at the generating plant, thus obviating the need to transmit the power over Idaho Power’s lines.

Distribution—Distribution expenses increased from \$37.6 million in 2002 to \$39.1 million in 2003, an increase of \$1.5 million (3.9%). Decreases in the cost of tree-trimming (\$1.7 million) and

apprenticeship programs (\$0.5 million) were partially offset by increases in maintenance of the overhead system (\$1.0 million) for storm damage repair and other corrective maintenance, safety program (\$0.2 million) and maintenance of underground systems (\$0.2 million). In addition, planning costs totaling \$1.5 million related to transportation infrastructure projects and the redevelopment of the South Lake Union area were expensed in 2003; there were no corresponding expenses in 2002.

Customer Services—The cost of customer services increased from \$27.6 million in 2002 to \$31.1 million in 2003, an increase of \$3.5 million (12.7%). The increase is primarily attributable to growth in bad debt expenses, which increased from \$5.2 million in 2002 to \$8.9 million in 2003, an increase of \$3.7 million. Bad debt expenses for retail electric accounts increased from \$5.0 million in 2002 to \$7.4 million in 2003, reflecting the downturn in the local economy and the substantial rate increases implemented by the Department in 2001. The bankruptcy of two counterparties to which the Department had delivered wholesale power in 2003 left the Department with \$1.0 million in receivables with uncertain prospects of recovery and that amount was expensed. Bad debt expenses in nonelectric accounts also increased by \$0.2 million from 2002 to 2003.

Conservation—Conservation expenses increased from \$9.5 million in 2002 to \$11.0 million in 2003, an increase of \$1.5 million (15.8%). Programmatic conservation expenditures are deferred and amortized over the anticipated 20-year life of the conservation improvements. Most of the increase in expense from 2002 to 2003 is attributable to the amortization of past conservation investments, which increased from \$7.4 million in 2002 to \$8.3 million in 2003. Conservation costs that are expensed on a current basis increased from \$2.1 million in 2002 to \$2.7 million in 2003.

Administration and General—Administration and general expenses increased by \$7.1 million (17.6%), from \$40.3 million in 2002 to \$47.4 million in 2003. The amount expensed to recognize the Department’s liability for cleanup of a Superfund site on the Duwamish Waterway increased by \$3.4 million. Judgments and claims

were \$0.9 million higher than in 2002. Legal fees, including the cost of pursuing the Department's claims for a refund of power costs incurred during the power crisis of 2001, increased by \$1.5 million. New oversight functions created in 2003, including the Department's Advisory Board, added \$0.7 million to expenses. Information technology costs increased by \$1.3 million over the 2002 level for the network, desktop support services, and automated systems including asset management and human resources. Other general administrative and engineering expenses increased by a net \$2.2 million. Administration and general costs applied to capital improvement projects and other deferred projects were \$0.3 million lower in 2003. Offsetting these increases was a \$3.2 million reduction in industrial insurance costs.

Depreciation—Depreciation expense rose from \$66.5 million in 2002 to \$69.3 million in 2003, an increase of \$2.8 million (4.2%), reflecting increases in net plant as the Department implemented its capital improvement program. The increases were concentrated in distribution and general plant (including data processing hardware and software), each of which showed an increase of \$1.1 million.

Taxes—Tax expenses increased by \$1.4 million (2.4%), from \$60.2 million in 2002 to \$61.6 million in 2003. Revenue-based taxes payable to the City of Seattle and the state of Washington were \$0.7 million lower than in 2002, due to the reduction in retail revenue. However, payments to suburban jurisdictions increased from \$2.1 million in 2002 to \$2.8 million in 2003, due largely to the initiation of payments to the City of Tukwila under their new franchise agreement with Seattle. Assessments related to tax audits added \$1.1 million to expenses in 2003.

NONOPERATING REVENUE (EXPENSE)

Investment Income—Income from the investment of the Department's available cash balances fell from \$10.1 million in 2002 to \$3.8 million in 2003. Interest earnings on the construction account decreased by \$3.3 million, from \$4.5 million to \$1.2 million as proceeds from the sale of bonds in 2001 were expended and as interest rates fell. Lower interest rates account for a decrease of \$0.8 million in interest earnings on the investment of balances in the

bond reserve account. Adjusting the value of the Department's investments at year end to reflect fair market value resulted in a charge of \$2.5 million. Offsetting these decreases was an increase of \$0.4 million in interest earned on the investment of operating cash balances in the City's cash pool.

Debt Expense—Interest expense, plus the amortization of debt-related costs, was \$7.0 million lower in 2003 than in 2002, declining from \$84.1 million to \$77.1 million. Interest costs related to revenue anticipation notes issued in 2001 and 2002 to finance power costs during the 2001 power crisis fell from \$8.9 million in 2002 to \$4.8 million in 2003 as the notes were retired in March and November 2003. Interest on the Department's loans from the City's cash pool declined from \$2.6 million to \$0.5 million as both the amount of borrowing and interest rates decreased. The refunding of \$86.6 million of first lien bonds in December 2002 and the retirement of outstanding bonds at their scheduled maturity resulted in a reduction of interest on first-lien bonds from \$71.9 million to \$71.3 million. Low short-term interest rates resulted in a reduction of \$0.4 million in interest expense on second-lien bonds, most of which have interest rates reset on a weekly basis. The allowance for funds used during construction, which is a credit against interest expense, was \$0.7 million higher in 2003 than in 2002, lowering interest expense by the same amount. Other expenses, including the amortization of debt-related costs, rose by \$0.8 million from the 2002 level.

Contributions and Grants—Contributions in aid of construction and grants more than doubled from \$13.0 million in 2002 to \$26.1 million in 2003. The Bonneville Power Administration reimbursed the Department for \$3.6 million of costs incurred by the Department for the North Seattle transmission reinforcement project. Other contributions increased by \$2.0 million. Donations of facilities constructed in connection with arterial improvement projects showed an increase of \$7.7 million. Grants related to local and regional transit projects added \$1.7 million to this category. Offsetting these increases was a reduction of \$1.8 million in contributions associated with nonstandard service installations.

FINANCIAL POSITION

Significant capital assets and related long-term debt

As of December 31,	2003	2002
SIGNIFICANT CAPITAL ASSETS:		
Utility plant—at original cost:		
Hydraulic	\$ 558,719,929	\$ 527,022,003
Capacity rights—3rd AC Intertie	34,298,665	34,298,666
Transmission	111,682,093	105,652,942
Distribution	1,139,408,622	1,068,429,863
General plant	308,571,436	297,080,941
	2,152,680,745	2,032,484,415
Less accumulated depreciation	(914,978,513)	(862,964,940)
	1,237,702,232	1,169,519,475
Construction work-in-progress	101,523,497	135,358,152
Nonoperating property—		
net of accumulated depreciation	11,860,650	7,703,571
Land and land rights	39,770,983	32,854,384
	\$1,390,857,362	\$1,345,435,582
SIGNIFICANT LONG-TERM DEBT		
RELATED TO CAPITAL ASSETS:		
Revenue bonds	\$1,235,574,847	\$1,176,151,459
Bond premium—net	22,932,295	12,652,403
Less deferred charges		
on advanced refunding	(31,260,375)	(33,124,397)
Note payable—City of Seattle	5,158,625	
	\$1,232,405,392	\$1,155,679,465
INVESTED IN CAPITAL ASSETS—		
NET OF RELATED DEBT:	\$ 158,451,970	\$ 189,756,117

CONDENSED BALANCE SHEETS

As of December 31,	2003	2002
Assets:		
Utility plant	\$ 1,390,857,362	\$1,345,435,582
Capitalized purchased power		
commitment	45,130,152	50,279,621
Restricted assets	159,432,145	240,881,958
Current assets	178,234,062	190,990,153
Other assets	286,898,970	377,433,352
Total assets	\$ 2,060,552,691	\$2,205,020,666
Liabilities:		
Long-term debt	\$ 1,462,609,162	\$1,365,447,879
Noncurrent liabilities	55,717,497	67,994,521
Current liabilities	215,129,588	452,101,465
Deferred credits	36,970,209	21,216,712
Total liabilities	1,770,426,456	1,906,760,577
Equity:		
Invested in capital assets—		
net of related debt	158,451,970	189,756,117
Restricted:		
Deferred power costs	100,000,000	200,000,000
Other	56,831,686	68,755,147
Unrestricted	(25,157,421)	(160,251,175)
	290,126,235	298,260,089
Total liabilities and equity	\$ 2,060,552,691	\$2,205,020,666

UTILITY PLANT

Utility plant at original cost increased \$120.2 million.

The hydroelectric system increased \$31.7 million, of which 77.3% was for Boundary dam and included accessory electrical equipment, structures and improvements, waterwheels and turbines, generators, and waterways.

Transmission plant increased \$6.0 million with station equipment at Bothell increasing \$4.2 million.

The distribution system increased \$71 million, primarily for conductors, conduits, and other devices (\$44.8 million). Poles and towers improvements increased \$7.5 million. Service improvements (to connect the Department's system to the customer's system) increased \$6.3 million and transformers increased \$6.1 million. Street lighting increased \$2.8 million, mostly within the Seattle city limits. Meters increased \$2.0 million.

General plant increased \$11.5 million, primarily due to a \$8.6 million increase for automated systems and \$3.7 million for communication equipment.

In addition to utility plant at original cost, land and land rights increased \$6.9 million, due primarily to acquisition of a property on Roy Street from the Seattle Parks Department for \$5.6 million.

COST CAPITALIZATION POLICIES

Administration and General ("A&G") Costs—The Department allocates a portion of A&G costs to the Capital Improvement and Conservation Program ("CICP"). A pool of allocable A&G costs is identified and an A&G allocation rate is computed by dividing the projected level of costs in the A&G cost pool in the following year by the projected number of non-A&G direct labor hours. Actual CICP labor hours are multiplied by the A&G allocation rate and included as a component of a CICP project. A&G costs capitalized were \$19.1 million and \$19.4 million in 2003 and 2002, respectively.

In addition, the Department allocates costs for pension and benefits to both CICP projects and operations and maintenance expenses. Pensions and benefits overhead applied totaled \$21.8 million and \$20.3 million in 2003 and 2002, respectively.

Data Processing Systems—Systems development costs related to major new data processing applications are capitalized.

High Ross—In setting rates for the 2000 to 2003 period, the City of Seattle Council decided to defer the capital portion of the remaining payments to B. C. Hydro under the High Ross agreement over the period through 2035. The deferred portion of the High Ross payments is treated as a component of capital requirements.

Capitalization Limit—The Department of Executive Administration revised the capitalization limit for the City of Seattle from \$1,000 to \$5,000 beginning in 2002. The effect of this change is an increase of approximately \$2.0 million of charges, which were expensed in 2002 rather than capitalized.

OTHER ASSETS

Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*, provides for the deferral of certain utility costs and related recognition in future years as the costs are recovered through future rates. Deferred costs are authorized by resolutions passed by the Seattle City Council, and include capitalized energy management services-net, deferred power costs, capitalized relicensing costs, and other deferred charges and assets. Detail for other deferred charges and assets-net, is provided in Note 10 to the accompanying financial statements.

Deferred assets totaled \$286.9 million at December 31, 2003, decreasing \$90.5 million from December 31, 2002. In 2001, \$300 million of short-term wholesale power costs were deferred for recovery through future revenues. In 2003 and in 2002, \$100 million of the deferred power costs were amortized each year. The balance of \$100 million is expected to be recovered by the end of 2004.

The Department is subject to true-up payments for the Department's fixed 4.6676 percentage of actual output and costs of Bonneville Slice power through October 1, 2011. In 2002, \$10.4 million was deferred for the Bonneville Slice contract true-up billing and \$1.9 million remained unamortized at December 31, 2003. A true-up credit for federal fiscal year 2003 in the amount of \$6.3 million was deferred as of December 31, 2003, and will be recognized during 2004. Bonneville rate adjustments will be passed through to retail electric customers in the form of rate adjustments in accordance with the rates ordinance.

LONG-TERM DEBT

Activity during the year for long-term debt included issuance of \$251.85 million in Municipal Light & Power Improvement and Refunding Revenue Bonds, 2003. The proceeds were used to fund the ongoing Capital Improvement Program and to defease certain prior lien bonds. Scheduled redemption of certain prior lien bonds also took place in the normal course of business. A note payable to the City of Seattle for \$5.6 million for purchase of real estate was also issued (see Note 6 of the accompanying financial statements).

After payment of cash operating expenses, net revenues available to pay debt service were equal to 2.5 times principal and interest on first-lien bonds. If, in addition, the amortization of \$100 million in power costs deferred from 2001 is taken into account, net revenues would be equal to 1.56 times first-lien debt service.

ENVIRONMENTAL LIABILITIES

Environmental liabilities totaled \$5.8 million and \$2.6 million at December 31, 2003 and 2002, respectively. The increase in the liability from 2002 is primarily attributable to the estimated cost of remediating contaminated sediments in the lower Duwamish Waterway, which was designated a federal Superfund site by the Environmental Protection Agency in 2001. The Department is considered a potentially responsible party for contamination in the Duwamish River due to land ownership or use of property located along the river.

RISK MANAGEMENT

The Department's exposure to market risk is actively managed by a Risk Management Committee. The Department is fundamentally risk averse, engaging in market transactions only to meet its load obligations or to lay off surplus energy. Except for strictly limited

and closely monitored intraday and interday trading to take advantage of owned hydro storage, the Department does not take market positions in anticipation of generating revenue.

With a significant portion of the Department's revenue expected from wholesale market sales, great emphasis is placed on the management of market risk. Processes, policies, and procedures designed to monitor and control these market risks, including credit risk, are in place and engagement in the market is strictly governed by those policies. Formal segregation of the roles of the front, middle, and back offices ensures compliance.

The Department measures the market price risk in its portfolio on a weekly basis using a modified revenue at risk measure that reflects not only price risk, but also the volumetric risk associated with its hydro-dominated power portfolio. Monte Carlo simulation is used to capture financial risk and scenario analysis for stress testing.

The Department takes a very conservative approach to managing volumetric risk, assuming 95% exceedance in hydro-generation until observed precipitation or snow pack surveys indicate otherwise.

While the Department's portfolio includes a gas turbine (a share of the Klamath plant), the Department's exposure to gas price excursions is limited, as the Department has monthly dispatch rights for that resource and only exercises those rights if the economics of operating the plant is favorable.

The Department mitigates credit risk by trading only with qualified counterparties. The Credit Committee, a subcommittee of the Risk Management Committee, establishes credit policies and counterparty limits based on approved criteria. The Committee monitors credit exposure and updates counterparty limits to reflect their most current financial condition and creditworthiness.

BALANCE SHEETS

As of December 31,	2003	2002
ASSETS		
UTILITY PLANT—At original cost:		
Plant in service—excluding land	\$ 2,152,680,745	\$ 2,032,484,415
Less accumulated depreciation	(914,978,513)	(862,964,940)
	1,237,702,232	1,169,519,475
Construction work-in-progress	101,523,497	135,358,152
Nonoperating property—net of accumulated depreciation	11,860,650	7,703,571
Land and land rights	39,770,983	32,854,384
	1,390,857,362	1,345,435,582
CAPITALIZED PURCHASED POWER COMMITMENT	45,130,152	50,279,621
RESTRICTED ASSETS:		
Municipal Light & Power Bond Reserve Account:		
Cash and equity in pooled investments	79,622,670	77,975,000
Bond proceeds and other:		
Cash and equity in pooled investments	7,406,387	158,267,512
Investments	68,244,446	
Special deposits and other	4,158,642	4,639,446
	159,432,145	240,881,958
CURRENT ASSETS:		
Cash and equity in pooled investments	9,347,170	34,694,513
Accounts receivable, net of allowance of \$12,630,000 and \$6,690,000	82,589,514	73,345,049
Unbilled revenues	61,194,790	60,079,107
Energy contracts	5,496,378	1,848,350
Materials and supplies at average cost	18,724,736	20,447,710
Prepayments, interest receivable, and other	881,474	575,424
	178,234,062	190,990,153
OTHER ASSETS:		
Capitalized energy management services—net	116,277,404	108,005,350
Deferred power costs	100,000,000	200,000,000
Capitalized relicensing costs	14,328,345	12,764,867
Other deferred charges and assets—net	56,293,221	56,663,135
	286,898,970	377,433,352
TOTAL	\$ 2,060,552,691	\$ 2,205,020,666

See notes to financial statements.

As of December 31,

2003

2002

LIABILITIES

LONG-TERM DEBT:

Revenue bonds	\$ 1,521,526,000	\$ 1,429,186,000
Plus bond premium—net	28,239,553	17,127,583
Less deferred charges on advanced refunding	(38,495,016)	(40,250,704)
Less revenue bonds—current portion	(53,820,000)	(40,615,000)
Note payable—City of Seattle	5,158,625	
	1,462,609,162	1,365,447,879

NONCURRENT LIABILITIES:

Accumulated provision for injuries and damages	10,491,426	7,895,490
Compensated absences	10,221,563	9,819,410
Long-term purchased power obligation	45,130,152	50,279,621
Less obligation—current portion	(10,300,000)	
Other	174,356	
	55,717,497	67,994,521

CURRENT LIABILITIES:

Accounts payable and other	52,222,132	71,842,294
Accrued payroll and related taxes	4,949,166	4,668,171
Compensated absences	495,974	846,948
Accrued interest	19,797,650	21,531,101
Revenue anticipation notes		307,210,000
Short-term borrowings—City of Seattle	70,000,000	
Long-term debt	53,820,000	40,615,000
Purchased power obligation	10,300,000	
Energy contracts	3,544,666	5,387,951
	215,129,588	452,101,465

DEFERRED CREDITS

	36,970,209	21,216,712
Total liabilities	1,770,426,456	1,906,760,577

COMMITMENTS AND CONTINGENCIES (Note 13)

EQUITY:

Invested in capital assets—net of related debt	158,451,970	189,756,117
Restricted:		
Deferred power costs	100,000,000	200,000,000
Other	56,831,686	68,755,147
Unrestricted	(25,157,421)	(160,251,175)
	290,126,235	298,260,089

TOTAL

	\$ 2,060,552,691	\$ 2,205,020,666
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STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN EQUITY

Years Ended December 31,	2003	2002
OPERATING REVENUES:		
Retail power revenues	\$ 552,232,914	\$ 562,432,218
Short-term wholesale power revenues	137,650,966	102,082,572
Other power-related revenues	34,082,244	20,385,528
Other	15,039,174	12,991,925
	739,005,298	697,892,243
OPERATING EXPENSES:		
Long-term purchased power	240,505,211	222,943,642
Short-term wholesale power purchases	24,232,720	12,440,806
Amortization of deferred power costs	100,000,000	100,000,000
Other power expenses	21,139,577	8,147,996
Generation	20,210,903	18,546,296
Transmission	34,511,283	35,352,620
Distribution	39,116,032	37,649,578
Customer service	31,068,350	27,566,006
Energy management	11,014,634	9,514,572
Administrative and general	88,316,671	79,973,873
Administrative and general overhead applied	(40,924,230)	(39,658,495)
City of Seattle occupation tax	33,607,729	33,913,510
Other taxes	27,998,595	26,260,379
Depreciation	69,270,029	66,485,780
	700,067,504	639,136,563
Net operating income	38,937,794	58,755,680
NONOPERATING REVENUES (EXPENSES):		
Investment income	3,813,194	10,110,004
Interest expense	(73,934,677)	(81,340,397)
Amortization of debt expense	(3,120,011)	(2,717,316)
Other income-net	36,192	357,968
	(73,205,302)	(73,589,741)
Net loss before fees and grants	(34,267,508)	(14,834,061)
FEES AND GRANTS:		
Capital contributions	22,089,096	10,631,017
Grants	4,044,558	2,337,759
	26,133,654	12,968,776
NET LOSS	(8,133,854)	(1,865,285)
EQUITY:		
Beginning of year	298,260,089	300,125,374
End of year	\$ 290,126,235	\$ 298,260,089

See notes to financial statements.

STATEMENTS OF CASH FLOWS

Years Ended December 31,	2003	2002
OPERATING ACTIVITIES:		
Cash received from customers and counterparties	\$ 751,992,693	\$ 672,615,777
Cash paid to suppliers, employees, and counterparties	(468,444,688)	(375,770,304)
Taxes paid	(68,610,633)	(59,423,235)
Net cash provided by operating activities	214,937,372	237,422,238
NONCAPITAL FINANCING ACTIVITIES:		
(Repayment of) proceeds from Revenue Anticipation Note ("RAN")	(307,210,000)	125,922,862
Increase (decrease) in short-term borrowings—City of Seattle note	70,000,000	(100,000,000)
Interest paid on RAN	(7,324,362)	(8,541,075)
Interest paid on City of Seattle note	(216,284)	(2,910,225)
Grants received	2,235,516	1,289,390
Bonneville receipts for conservation augmentation	10,716,542	19,996,026
Payment to vendors on behalf of customers for conservation augmentation	(17,910,624)	(18,240,747)
Net cash (used in) provided by noncapital financing activities	(249,709,212)	17,516,231
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from long-term borrowing—net of discount	265,520,394	88,247,757
Payment to trustee for refunded bonds	(123,962,517)	(86,560,000)
Bond issue costs paid	(1,606,283)	(585,657)
Principal paid on long-term debt	(40,615,000)	(41,651,500)
Interest paid on long-term debt	(69,694,188)	(74,984,816)
Acquisition and construction of capital assets	(118,390,142)	(133,586,924)
Proceeds from sale of property, plant, and equipment	709,000	763,624
Contributions in aid of construction	10,811,821	11,578,573
Net cash (used in) capital and related financing activities	(77,226,915)	(236,778,943)
INVESTING ACTIVITIES:		
Proceeds from investments	40,650,838	216,780,918
Purchases of investments	(108,896,905)	(114,511,442)
Interest received on investments	5,203,219	10,230,016
Net cash (used in) provided by investing activities	(63,042,848)	112,499,492
NET (DECREASE) INCREASE IN CASH AND EQUITY IN POOLED INVESTMENTS	(175,041,603)	130,659,018
CASH AND EQUITY IN POOLED INVESTMENTS:		
Beginning of year	275,576,471	144,917,453
End of year	\$ 100,534,868	\$ 275,576,471

(continued)

STATEMENTS OF CASH FLOWS

Years Ended December 31,	2003	2002
RECONCILIATION OF NET OPERATING INCOME		
TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net operating income	\$ 38,937,794	\$ 58,755,680
Adjustments to reconcile operating income		
to net cash provided by operating activities:		
Depreciation and amortization	79,981,627	76,288,439
Amortization of deferred power costs	100,000,000	100,000,000
Change in:		
Accounts receivable	(3,974,205)	(15,586,755)
Unbilled revenues	(1,115,683)	1,287,056
Materials and supplies	1,722,974	3,895,411
Prepayments, interest receivable, and other	(3,954,078)	(571,654)
Capitalized relicensing and other deferred	7,679,878	12,210,283
Provision for injuries and damages and claims payable	3,181,299	1,770,185
Accounts payable, accrued payroll, and other	(19,924,530)	6,800,764
Compensated absences	51,179	13,006
Energy contracts and deferred credits	12,351,117	(7,440,177)
Total adjustments	175,999,578	178,666,558
Net cash provided by operating activities	\$ 214,937,372	\$ 237,422,238
SUPPLEMENTAL DISCLOSURES OF NONCASH ACTIVITIES:		
In-kind capital contributions	\$ 9,220,363	\$ 1,566,788
Note payable incurred for purchase of property	\$ 5,565,000	\$ -

See notes to financial statements.

(Concluded)

NOTES TO FINANCIAL STATEMENTS Years Ended December 31, 2003 and 2002

1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City Light Department (the “Department”) is the public electric utility of the City of Seattle (the “City”). The Department owns and operates certain generating, transmission, and distribution facilities and supplies electricity to approximately 365,445 customers. The Department supplies electrical energy to other City agencies at rates prescribed by City ordinances. The establishment of the Department’s rates is within the exclusive jurisdiction of the Seattle City Council. A requirement of Washington State law provides that rates must be fair, nondiscriminatory, and fixed to produce revenue adequate to pay for operation and maintenance expenses and to meet all debt service requirements payable from such revenue. The Department pays occupation taxes to the City based on total revenues.

The Department’s revenues were \$6.4 million and \$6.0 million for electrical energy and \$1.9 million and \$2.3 million for nonenergy services provided to other city funds in 2003 and 2002, respectively.

The Department receives certain services from other City funds and paid approximately \$35.7 million and \$36.9 million, respectively, in 2003 and 2002 for such services.

Accounting Standards—The accounting and reporting policies of the Department are regulated by the Washington State Auditor’s Office, Division of Municipal Corporations, and are based on the Uniform System of Accounts prescribed for public utilities and licensees by the Federal Energy Regulatory Commission (“FERC”). The financial statements are also prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board (“GASB”) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Department has applied all applicable GASB pronouncements as well as the following pronouncements, except for those that conflict with or contradict GASB pronouncements: Statements and Interpretations of the Financial Accounting Standards Board (“FASB”), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures. The more significant of the Department’s accounting policies are described below.

In June 1999, the GASB issued GASB Statement No. 34, *Basic Financial Statements-and Management’s Discussion and Analysis-for State and Local Governments*, adopted by the Department in 2002 with the following amendments: GASB Statement No. 37, *Basic Financial Statements-and Management’s Discussion and Analysis-for State and Local Governments: Omnibus-an Amendment of GASB Statements No. 21 and No. 34*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. GASB Statement No. 34, as amended, and GASB Statement No. 38 establish specific standards for external financial reporting for state and local governments. As a result of adopting these statements in 2002, the basic financial statement presentation was significantly changed, including adding management’s discussion and analysis of operating, investing, and financing activities.

GASB Statement No. 34 also requires the classification of fund equity into three components: invested in capital assets-net of related debt, restricted, and unrestricted, defined as follows:

- *Invested in capital assets-net of related debt* consists of capital assets, net of accumulated depreciation reduced by the net outstanding debt balances.
- *Restricted net assets* has constraints placed on use, either externally or internally. Constraints include those imposed by creditors (such as through debt covenants), grants, or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation or by the Seattle City Council.
- *Unrestricted net assets (deficit)* consists of assets and liabilities that do not meet the definition of “restricted net assets” or “invested in capital assets-net of related debt.”

Under GASB Statement No. 34, the statement of operations and changes in retained earnings was renamed the statement of revenues, expenses, and changes in equity.

In June 2001, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for legal or contractual obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires the recording of the fair value of a liability

for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the associated costs of the asset retirement obligation will be capitalized as part of the carrying amount of the related long-lived asset. The liability will be accreted to its present value each period and the related capitalized costs will be depreciated over the useful life of the related asset. Upon retirement of the asset, the Department will either settle the retirement obligation for its recorded amount or incur a gain or loss. The adoption of this statement on January 1, 2003, did not have a material effect on the Department's financial position or operations.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. The Department has entered into certain forward contracts to purchase or sell power that may no longer meet the normal purchases and sales exception in accordance with the provisions of SFAS No. 149. This statement requires these types of forward contracts to purchase or sell power, which were entered into on or after July 1, 2003, be recorded as assets or liabilities at market value with an offsetting regulatory asset or liability as allowed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*.

In July 2003, the Emerging Issues Task Force ("EITF") reached consensus on Issue No. 03-11, *Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not "Held for Trading Purposes"* as Defined in EITF Issue No. 02-3. This EITF issue requires that revenues and expenses from the Department's settled energy contracts that are "booked out" (not physically delivered) should be reported on a net basis as part of operating revenues. As allowed by this EITF issue, the Department applied these provisions for the entire year in 2003 and reclassified 2002 to conform to current-year presentation. Booked-out power transactions reduced revenues and expenses by \$21.3 million and \$10.7 million in 2003 and 2002, respectively.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. This statement establishes and modifies disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk. The requirements of this statement are effective for the Department's financial

statements for periods beginning after June 15, 2004 (January 1, 2005). The Department is in the process of determining the impact of this standard on its financial statements.

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. The Department will adopt this statement effective January 1, 2005; however, the Department does not expect a material impact on its financial position or results of operations.

In June 2003, the GASB issued Technical Bulletin No. 2003-1 ("TB 03-1"), *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, which supersedes Technical Bulletin 94-1 and clarifies guidance on derivative disclosures, pending the results of the GASB's project on reporting and measurement of derivatives and hedging activities. TB 03-1 is effective for fiscal years ending after June 15, 2003, and was adopted by the Department in 2003 without material impact to financial position or operations.

Utility Plant—Utility plant is recorded at original cost, which includes both direct costs of construction or acquisition and indirect costs, including an allowance for funds used during construction. The allowance represents the estimated costs of financing construction projects and is computed using the Department's long-term borrowing rate. The allowance totaled \$4.3 million and \$3.6 million in 2003 and 2002, respectively, and is reflected as a reduction of interest expense in the statements of revenues, expenses, and changes in equity. Property constructed with capital fees received from customers is included in utility plant. Capital fees totaled \$22.1 million in 2003 and \$10.6 million in 2002. Provision for depreciation is made using the straight-line method based upon estimated economic lives, which range from three to 50 years, of related operating assets. The Department uses a half-year convention method on the assumption that additions and replacements are placed in service at mid-year. The composite depreciation rate was approximately 3.2% in 2003 and 3.3% in 2002. When operating plant assets are retired, their original cost together with removal costs,

less salvage, is charged to accumulated depreciation. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and betterments is capitalized. The Department periodically reviews long-lived assets for impairment to determine whether any events or circumstances indicate the carrying value of the assets may not be recoverable. No impairment was identified in 2002 or 2003.

Restricted Assets—In accordance with the Department's bond resolutions, state law, or other agreements, separate restricted assets have been established. These assets are restricted for specific purposes, including the establishment of the Municipal Light & Power ("ML&P") Bond Reserve Account, financing of the Department's ongoing Capital Improvement Program, and other purposes.

Compensated Absences—Permanent employees of the Department earn vacation time in accordance with length of service. A maximum of 480 hours may be accumulated and, upon termination, employees are entitled to compensation for unused vacation. At retirement, employees receive compensation equivalent to 25% of their accumulated sick leave. The Department accrues all costs associated with compensated absences, including payroll taxes.

Accounts Payable and Other—The composition of accounts payable and other at December 31 is as follows:

	2003	2002
Vouchers payable	\$ 7,471,873	\$10,090,145
Power accounts payable	24,540,593	40,354,341
Interfund payable	5,892,236	6,566,460
Taxes payable	9,528,936	8,541,055
Claims payable—current	3,166,115	2,580,752
Guarantee deposit and contract retainer	1,502,526	1,998,070
Other accounts payable	119,853	1,711,471
	\$52,222,132	\$71,842,294

Revenue Recognition—Service rates are authorized by City ordinances. Billings are made to customers on a monthly or bimonthly basis. Revenues for energy delivered to customers between the last billing date and the end of the year are estimated and reflected in the accompanying financial statements under the caption unbilled revenues.

The Department's customer base comprises four identifiable groups, which accounted for electric energy sales as follows:

	2003	2002
Residential	36.1 %	37.6 %
Commercial	44.2	42.3
Industrial	10.5	11.2
Governmental	9.2	8.9
	100.0 %	100.0 %

Nonexchange Transactions—Capital contributions and grants in the amount of \$26.1 million and \$13.0 million are reported for 2003 and 2002, respectively, on the statements of revenues, expenses, and changes in equity as nonoperating revenues from nonexchange transactions. In-kind capital contributions are recognized at fair value and are generally based either on the internal engineer's estimate of the current cost of comparable plant in service or the donor's actual cost.

Use of Estimates—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements. The Department used significant estimates in determining reported unbilled revenues, energy contract assets and liabilities, accumulated provision for injuries and damages, allowance for doubtful accounts, accrued sick leave, and other contingencies. Actual results may differ from those estimates.

Significant Risk and Uncertainty—The Department is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include prices on the wholesale markets for short-term power transactions; interest rates; water conditions, weather, and natural disaster related disruptions; terrorism; collective bargaining labor disputes; fish and other Endangered Species Act ("ESA") issues; Environmental Protection Agency ("EPA") regulations; federal government regulations or orders concerning the operations, maintenance, and/or licensing of hydroelectric facilities; other governmental regulations; the deregulation of the electrical utility industry; and the costs of constructing transmission facilities that may be incurred as part of a regional transmission system.

Reclassifications—Certain 2002 account balances have been reclassified to conform to the 2003 presentation.

2. UTILITY PLANT

Utility plant in service at original cost, excluding land, at December 31, 2003, consists of:

	Hydraulic Production	Transmission	Distribution	General	Total
Beginning balance	\$527,022,003	\$139,951,608	\$1,068,429,863	\$297,080,941	\$ 2,032,484,415
Capital acquisitions	36,972,921	6,406,711	68,394,546	16,843,145	128,617,323
Dispositions	(5,279,046)	(295,449)	(2,637,960)	(5,352,650)	(13,565,105)
Transfers and adjustments	4,051	(82,112)	5,222,173		5,144,112
	558,719,929	145,980,758	1,139,408,622	308,571,436	2,152,680,745
Less accumulated depreciation	(279,420,331)	(62,863,342)	(410,090,161)	(162,604,679)	(914,978,513)
Ending balance	\$279,299,598	\$ 83,117,416	\$ 729,318,461	\$145,966,757	\$ 1,237,702,232

FERC licenses for owned hydraulic production facilities consist of:

Project	License Issued	License Effective	License Expires	Years Licensed
Boundary	10/01/1961	10/01/1960	10/01/2011	50
Gorge	05/16/1995	05/01/1995	05/01/2025	30
Diablo	05/16/1995	05/01/1995	05/01/2025	30
Ross	05/16/1995	05/01/1995	05/01/2025	30
Newhalem	02/07/1997	02/01/1997	02/01/2027	30
South Fork Tolt	03/29/1984	03/01/1984	03/01/2024	40

See *Endangered Species* within Note 13 for contingent relicensing requirements regarding Boundary relicensing.

3. CASH AND EQUITY IN POOLED INVESTMENTS AND INVESTMENTS

Cash and Equity in Pooled Investments and Investments—The City pools and invests all temporary cash surpluses for City departments. These residual investments may consist of deposits with qualified public depositories; obligations of the United States or its agencies or wholly owned corporations; obligations of eligible government-sponsored enterprises; and certain bankers' acceptances, commercial paper, general obligation bonds or warrants, repurchase agreements, reverse repurchase agreements, mortgage-backed securities, derivative-based securities, and participation in the State Treasurer's local government investment pool, and are in accordance with the Revised Code of Washington 35.39.032 and 39.58. According to City policy, securities purchased will have a maximum maturity of no longer than 15 years, and the average maturity of all securities owned should be no longer than five years. Also by City policy, the City may operate a securities lending program, and there were transactions during 2003 and 2002. There were no securities lending program transactions outstanding at year-end 2003 or 2002. The Department's equity in residual investments is reflected as cash and equity in pooled investments. The City's residual investment pool did not include reverse repurchase agreements at the end of 2003 or 2002; the City did not invest in such instruments during 2003 or 2002. Derivative-based securities were owned by the City pool during 2003 and 2002 and at both year ends. These securities were callable U.S. government agency instruments. Earnings and adjustments to fair value from the investment pool are prorated monthly to City departments based on the average daily cash balances of participating funds.

Banks or trust companies acting as the City's agents hold most of the City's investments in the City's name, with respect to credit risk as defined in GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. All transactions are executed with authorized security dealers, financial institutions, or securities lending agents on a delivery versus payment basis.

The first \$100,000 of bank deposits are federally insured. The Washington State Public Deposit Protection Commission ("PDPC") collateralizes deposits in excess of \$100,000. The PDPC is a multiple financial institution collateral pool. There is no provision for the PDPC to make additional pro rata assessments if needed to cover a loss. Therefore, the PDPC protection is of the nature of collateral, not of insurance.

Securities with maturities exceeding three months at time of purchase are reported at fair value on the balance sheets; the net increase (decrease) in the fair value of those investments is reported as part of investment income. At December 31, changes in the fair value of investments resulted in an unrealized loss of \$1.7 million for 2003 and an unrealized gain of \$.8 million for 2002.

The cash pool operates like a demand deposit account in that all City departments, including the Department, may deposit cash at any time and can also withdraw cash out of the pool without prior notice or penalty. Accordingly, the statements of cash flows reconcile to cash and equity in pooled investments.

Cash and cash equivalents included in cash and equity in pooled investments at December 31 consists of:

	2003	2002
Restricted assets:		
Municipal Light and Power Bond		
Reserve Account	\$14,486,404	\$24,998,402
Bond proceeds and other	1,348,695	51,152,110
Special deposits and other	4,158,641	4,639,446
	19,993,740	80,789,958
Current assets	1,700,368	11,425,127
	\$21,694,108	\$92,215,085

Equity in pooled investments and U.S. government securities are reported at fair values based on quoted market prices for those or similar securities and are as follows at December 31:

	2003	2002
Restricted assets:		
Municipal Light & Power Bond		
Reserve Account:		
Equity in pooled investments	\$65,136,266	\$ 52,976,598
Bond proceeds and other:		
Equity in pooled investments	6,057,692	107,115,402
	71,193,958	160,092,000
Current assets:		
Equity in pooled investments	7,646,802	23,269,386
	\$78,840,760	\$183,361,386

4. ACCOUNTS RECEIVABLE

Accounts receivable at December 31 consists of:

	Retail Power	Wholesale Power	Fees, Grants, and Other	Interfund	Due from Other Governments	Total
2003:						
Accounts receivable	\$59,257,341	\$23,897,296	\$5,125,240	\$1,458,279	\$5,481,358	\$95,219,514
Less allowance for doubtful accounts	(8,850,000)	(2,570,000)	(1,210,000)			(12,630,000)
	\$50,407,341	\$21,327,296	\$3,915,240	\$1,458,279	\$5,481,358	\$82,589,514
2002:						
Accounts receivable	\$57,304,001	\$13,950,626	\$4,693,499	\$2,626,871	\$1,460,052	\$80,035,049
Less allowance for doubtful accounts	(4,000,000)	(1,520,000)	(1,170,000)			(6,690,000)
	\$53,304,001	\$12,430,626	\$3,523,499	\$2,626,871	\$1,460,052	\$73,345,049

5. SHORT-TERM POWER CONTRACTS AND DERIVATIVE INSTRUMENTS

The Department enters into forward contracts to purchase or sell energy. Under these forward contracts, the Department commits to purchase or sell a specified amount of energy at a specified time, or during a specified time in the future. Certain of the forward contracts are considered derivatives. These derivatives, along with other short-term power transactions, are entered into solely for the purpose of managing the Department's resources to meet load requirements. The Department does not take market positions in anticipation of generating revenue, with the exception of strictly limited and closely monitored intraday and interday trading to find value in the Department's portfolio by creating and selling services that use the flexibility of the Department's owned hydro system and to take advantage of owned hydro storage. Power transactions in response to forecasted seasonal resource and demand variations require approval by the Department's Risk Management Committee. Fluctuations in annual precipitation levels and other weather conditions materially affect the energy output from the Department's hydroelectric facilities and some of its long-term purchased hydroelectric power agreements. Demand fluctuates with weather and local economic conditions. Accordingly, short-term power transactions required to manage resources to meet the Department's load and dispose of surplus energy may vary from year to year.

Information related to the Department's short-term wholesale power contracts outstanding as of December 31 are as follows:

	2003	2002
Wholesale power purchases outstanding	\$1,911,881	\$2,940,900
Megawatt hours ("MWh")	54,725	88,800
Average contract purchase cost per MWh	\$34.94	\$33.12
Wholesale power sales outstanding	\$74,967,251	\$54,206,420
MWh	2,329,107	1,570,000
Average contract sales price per MWh	\$32.19	\$34.53

The fair market value of derivative instruments held by the department as of December 31 is as follows:

	2003	2002
Assets:		
Energy contracts:		
Forward energy sales	\$5,492,487	\$1,452,182
Forward energy purchases	3,891	396,168
Other deferred charges—net:		
Unrealized losses from fair valuation of:		
Forward energy sales		3,935,769
Forward energy purchases	163,664	
	\$5,660,042	\$5,784,119
Liabilities:		
Energy contracts:		
Forward energy sales	\$3,377,111	\$5,387,951
Forward energy purchases	167,555	
Deferred credits:		
Unrealized gains from fair valuation of:		
Forward energy sales	2,115,376	
Forward energy purchases		396,168
	\$5,660,042	\$5,784,119

6. LONG-TERM AND SHORT-TERM DEBT

At December 31, the Department's long-term and short-term debt consisted of the following:

				2003	2002
LONG-TERM					
Prior Lien Bonds:					
2003	ML&P Improvement and Refunding Revenue Bonds	4.000% to 6.000%	due 2028	\$ 251,850,000	\$ –
2002	ML&P Refunding Revenue Bonds	3.000% to 4.500%	due 2014	85,275,000	87,735,000
2001	ML&P Improvements and Refunding Revenue Bonds	5.000% to 5.500%	due 2026	503,700,000	503,700,000
2000	ML&P Revenue Bonds	4.500% to 5.625%	due 2025	98,830,000	98,830,000
1999	ML&P Revenue Bonds	5.000% to 6.000%	due 2024	158,000,000	158,000,000
1998B	ML&P Revenue Bonds	4.750% to 5.000%	due 2024	90,000,000	90,000,000
1998A	ML&P Refunding Revenue Bonds	4.500% to 5.000%	due 2020	102,120,000	102,835,000
1997	ML&P Revenue Bonds	5.000% to 5.125%	due 2022	29,070,000	30,000,000
1996	ML&P Revenue Bonds	5.250% to 5.625%	due 2021	28,230,000	29,135,000
1995B	ML&P Revenue Bonds	4.050% to 4.800%	due 2005	456,000	456,000
1995A	ML&P Revenue Bonds	5.000% to 5.700%	due 2020	53,875,000	55,815,00
1994	ML&P Revenue Bonds	6.00%	due 2004	3,450,000	6,280,000
1993	ML&P Revenue & Refunding Revenue Bonds	2.200% to 5.500%	due 2004	20,215,000	166,360,000
				1,425,071,000	1,329,146,000
Subordinate Lien Bonds:					
1996	ML&P Adjustable Rate Revenue Bonds	variable	due 2021	18,455,000	19,140,000
1993	ML&P Adjustable Rate Revenue Bonds	variable	due 2018	17,800,000	18,700,000
1991B	ML&P Adjustable Rate Revenue Bonds	variable	due 2016	16,500,000	17,500,000
1991A	ML&P Adjustable Rate Revenue Bonds	variable	due 2016	25,000,000	25,000,000
1990	ML&P Adjustable Rate Revenue Bonds	variable	due 2015	18,700,000	19,700,000
				96,455,000	100,040,000
City of Seattle:					
2003	Note payable	5.000%	due 2005	5,158,625	
Total long-term debt				\$ 1,526,684,625	\$ 1,429,186,000
SHORT-TERM					
Revenue Anticipation Notes:					
2001	ML&P Revenue Anticipation Notes	4.500% and 5.250%	due 2003	\$ –	\$ 182,210,000
2002	ML&P Revenue Anticipation Notes	2.500%	due 2003		125,000,000
					307,210,000
City of Seattle:					
2003	Short-term borrowings—City of Seattle	variable	due 2004	70,000,000	
Total short-term debt				\$ 70,000,000	\$ 307,210,000

The Department had the following activity in long-term debt during 2003:

	Balance at 12/31/02	Additions	Reductions	Balance at 12/31/03	Current Portion
Prior Lien Bonds	\$1,329,146,000	\$251,850,000	\$(155,925,000)	\$1,425,071,000	\$49,705,000
Subordinate Lien Bonds	100,040,000		(3,585,000)	96,455,000	4,115,000
Note payable—City of Seattle		5,565,000	(406,375)	5,158,625	
	\$1,429,186,000	\$257,415,000	\$(159,916,375)	\$1,526,684,625	\$53,820,000

Prior Lien Bonds—In August 2003, the Department issued \$251.8 million in ML&P Improvement and Refunding Revenue Bonds that bear interest at rates ranging from 4.00% to 6.00% and mature serially from November 1, 2004, through 2025. Term bonds mature on November 1, 2028. The arbitrage yield for the 2003 bonds is 4.335%. Arbitrage yield, when used in computing the present worth of all payments of principal and interest on the bonds, produces an amount equal to the issue price of the bonds. Proceeds were used to finance certain capital improvements and conservation programs and to defease certain outstanding prior lien bonds. The debt service on the improvement and refunding bonds requires a cash flow of \$393.4 million, including \$141.5 million in interest. The difference between the cash flows required to service the old and the new debt and complete the refunding totaled \$5.8 million, and the aggregate economic gain totaled \$5.4 million at net present value. The loss on refunding was \$15.0 million and is being amortized using the effective interest method over the life of the new bonds. The unamortized balance of the loss on refunding at December 31, 2003, was \$14.0 million.

In December 2002, the Department issued \$87.7 million in ML&P Refunding Revenue Bonds that bear interest at rates ranging from 3.00% to 4.50% and mature serially from December 1, 2003, through 2014. The arbitrage yield for the 2002 bonds is 3.427%. Proceeds were used to defease certain outstanding prior lien bonds. The debt service on the refunding bonds requires a cash flow of \$110.4 million, including \$22.7 million in interest. The difference between the cash flows required to service the old and the new debt and complete the refunding totaled \$5.1 million, and the aggregate economic gain totaled \$5.97 million at net present value. The loss on refunding was \$8.9 million and is being amortized using the effective interest method over the life of the new bonds. The unamortized balance of the loss on refunding at December 31, 2003 and 2002, was \$7.8 million and \$8.8 million, respectively.

Future debt service requirements for prior-lien bonds are as follows:

Year Ending December 31	Principal Redemptions	Interest Requirements	Total
2004	\$ 49,705,000	\$ 73,667,837	\$ 123,372,837
2005	52,781,000	71,551,006	124,332,006
2006	56,225,000	69,253,098	125,478,098
2007	58,945,000	66,524,336	125,469,336
2008	62,055,000	63,416,923	125,471,923
2009 – 2013	330,545,000	265,864,239	596,409,239
2014 – 2018	342,990,000	175,408,036	518,398,036
2019 – 2023	309,815,000	86,824,202	396,639,202
2024 – 2028	162,010,000	15,435,510	177,445,510
	\$1,425,071,000	\$887,945,187	\$2,313,016,187

The Department is required by ordinance to fund reserves for prior lien bond issues in an amount equal to the lesser of (a) the maximum annual debt service on all bonds secured by the reserve account or (b) the maximum amount permitted by the Internal Revenue Code ("IRC") of 1986 as a reasonably required reserve or replacement fund. Upon issuance of the 2003 bonds, the maximum annual debt service on prior lien bonds remained at \$125.5 million. The IRC's requirement decreased from \$113.5 million to \$113.3 million. At December 31, 2003, the balance in the reserve account was \$79.6 million at fair value. The reserve must be fully funded by August 1, 2008.

In addition to the 2003 refunding revenue bonds, the Department has previously issued several refunding revenue bonds for the purpose of defeasing certain outstanding prior lien bonds. Refunding revenue bonds were also issued in 2002, 2001, 1998, and 1993. Proceeds from the refunding bonds were placed in separate irrevocable trusts to provide for all future debt service payments on the bonds defeased. Accordingly, neither the assets of the respective trust accounts nor the liabilities for the defeased bonds are reflected in the Department's financial statements. The bonds defeased in 2003 and 2002 were called in full on November 1, 2003. The bonds defeased in 1998 and 1993 had outstanding principal balances of \$94.7 million and \$4.3 million, respectively, as of December 31, 2003. Funds held in the respective trust accounts on December 31, 2003, are sufficient to service and redeem the defeased bonds.

Subordinate Lien Bonds—The Department is authorized to issue a limited amount of adjustable rate revenue bonds, which are subordinate to prior lien bonds with respect to claim on revenues. Subordinate lien bonds may be issued to the extent that the new bonds will not cause the aggregate principal amount of such bonds then outstanding to exceed the greater of \$70 million or 15% of the aggregate principal amount of prior lien bonds then outstanding. Subordinate bonds may be remarketed daily, weekly, short-term, or long-term and may be converted to prior lien bonds when certain conditions are met.

In December 1996, the Department issued ML&P Adjustable Rate Revenue Bonds in the amount of \$19.8 million, subject to a mandatory redemption schedule spanning the period from June 1, 2002, to June 1, 2021. The bonds had an outstanding balance of \$18.5 million at December 31, 2003. These bonds were marketed weekly at an interest rate ranging from 0.60% to 1.30% during 2003. Proceeds were used to finance a portion of the capital improvement and conservation program.

The 1990 bonds and 1991 Series B bonds were marketed on a short-term basis during 2003, with interest rates ranging from 0.75% to 1.30%. The 1990 bonds and the 1991 Series B bonds had an outstanding balance of \$18.7 million and \$16.5 million, respectively, at December 31, 2003.

The 1991 Series A bonds and the 1993 bonds were priced weekly at interest rates from 0.64% to 1.23% in 2003. The 1991 Series A bonds and the 1993 bonds had an outstanding balance of \$25.0 million and \$17.8 million, respectively, at December 31, 2003.

Future debt service requirements on the subordinate lien bonds, based on 2003 end of year actual interest rates ranging from 0.90% to 1.06% through year 2021, are as follows:

Year Ending December 31	Principal Redemptions	Interest Requirements	Total
2004	\$ 4,115,000	\$1,014,316	\$ 5,129,316
2005	4,445,000	945,622	5,390,622
2006	4,775,000	888,514	5,663,514
2007	5,305,000	839,458	6,144,458
2008	5,840,000	786,227	6,626,227
2009 – 2013	36,530,000	2,926,206	39,456,206
2014 – 2018	31,380,000	871,852	32,251,852
2019 – 2021	4,065,000	64,381	4,129,381
	\$96,455,000	\$8,336,576	\$104,791,576

Revenue Anticipation Notes—In November 2002, the Department issued \$125.0 million in ML&P Revenue Anticipation Notes (“RANs”) at an interest rate of 2.50% with an arbitrage yield of 1.49%. The 2002 RANs matured in November 2003.

In March 2001, the Department issued \$182.2 million in ML&P RANs. \$136.7 million of the 2001 RANs had an interest rate of 4.50%, and \$45.5 million had an interest rate of 5.25%. The arbitrage yield of the 2001 RANs was 3.75%. The 2001 RANs matured in March 2003.

All RANs were special limited obligations of the Department payable from and secured by gross revenues. Proceeds were used to finance operating expenses for each respective year. The RANs were on a lien subordinate to prior lien bonds and subordinate lien bonds; there was no reserve account securing repayment, and there was no debt service coverage requirement. No debt service requirements are outstanding for the RANs as of December 31, 2003.

Fair Value—The fair value of the Department's bonds and RANs is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Department for debt of the same remaining maturities. Carrying amounts and fair values are as follows at December 31:

	2003 Carrying Amount	2003 Fair Value	2002 Carrying Amount	2002 Fair Value
Long-term debt:				
Prior lien bonds	\$1,453,551,784	\$1,528,392,143	\$1,344,779,509	\$1,407,056,096
Subordinate lien bonds	96,213,769	96,455,000	99,780,903	100,040,000
RANs			308,963,171	309,942,021
	\$1,549,765,553	\$1,624,847,143	\$1,753,523,583	\$1,817,038,117

Amortization—Bond issue costs, discounts, and premiums are amortized using the effective interest method over the term of the bonds.

The excess of costs incurred over the carrying value of bonds refunded on early extinguishment of debt is amortized as a component of interest expense using both the straight-line and effective interest methods over the terms of the issues to which they pertain. Deferred refunding costs amortized to interest expense totaled \$5.8 million in 2003 and \$4.2 million in 2002. Deferred refunding costs in the amount of \$38.5 million and \$40.3 million are reported as a component of long-term debt in the 2003 and 2002 balance sheets, respectively.

Note Payable—In 2003, the Department purchased real estate property for a potential future substation from the City of Seattle Department of Parks and Recreation at a price of \$5.6 million and financed it via a note payable to the Department of Parks and Recreation at 5%, maturing in July 2005. Debt service requirements for this note payable to maturity are:

Year Ending December 31	Principal Redemptions	Interest Requirements	Total
2003	\$ 406,375	\$ -	\$ 406,375
2004		257,932	257,932
2005	5,158,625	257,931	5,416,556
	\$5,565,000	\$515,863	\$6,080,863

Short-Term Borrowings—In late December 2001, the City of Seattle authorized an interfund loan (note payable) to the Department from the City's Consolidated (Residual) Cash Portfolio in an amount up to \$110.0 million, of which \$100 million was outstanding as of December 31, 2001. The purpose of the note payable was for working capital and it was due on or before March 31, 2003. The loan was repaid on January 1, 2002, and was carried as a negative operating cash balance during part of 2002. The loan was repaid in November 2002 with the 2002 RAN proceeds and was carried as a negative operating cash balance until maturity in March 2003.

Ordinance No. 121154 provided for a new interfund loan up to \$50 million for working capital purposes. The same ordinance authorized an additional interfund loan up to \$100 million beginning November 2003, expiring in December 2004. The amount outstanding as of December 31, 2003, was \$70 million. The interest rate for the note payable for each month during 2003 was equal to the rate of return earned for each respective month by the City's Consolidated (Residual) Cash Portfolio. The loan will be carried forward as a negative operating cash balance until maturity.

7. SEATTLE CITY EMPLOYEES' RETIREMENT SYSTEM

The Seattle City Employees' Retirement System ("SCERS") is a single-employer defined benefit, public employee retirement system, covering employees of the City and administered in accordance with Chapter 41.28 of the Revised Code of Washington and Chapter 4.36 of the Seattle Municipal Code. SCERS is a pension trust fund of the City.

All employees of the City are eligible for membership in SCERS with the exception of uniformed police and fire personnel who are covered under a retirement system administered by the state of Washington. Employees of Metro and the King County Health Department who established membership in SCERS when these organizations were City departments were allowed to continue their SCERS membership. As of December 31, 2003, there were 4,876 retirees and beneficiaries receiving benefits and 8,382 active members of SCERS. In addition, 1,389 vested terminated employees were entitled to future benefits, and 193 terminated employees had restored their contributions due to the provisions of the portability statutes and may be eligible for future benefits.

SCERS provides retirement, death, and disability benefits. Retirement benefits vest after five years of credited service, while death and disability benefits vest after 10 years of service. Retirement benefits are calculated as 2% multiplied by years of creditable service, multiplied by average salary, based on the highest 24 consecutive months, excluding overtime. The benefit is actuarially reduced for early retirement.

Actuarially recommended contribution rates both for members and for the employer were 8.03% of covered payroll during 2003 and 2002.

Under the authority of the state and City, SCERS operates a securities lending program, and there were transactions during 2003 and 2002. SCERS has had no losses resulting from a default, and SCERS did not have negative credit exposure at December 31, 2003 or 2002.

SCERS issues stand-alone financial statements that may be obtained by writing to the Seattle City Employees' Retirement System, 801 Third Avenue, Suite 300, Seattle, Washington 98104; telephone: (206) 386-1292.

Employer contributions for the City were \$34.2 million and \$36.6 million in 2003 and 2002, respectively, and the annual required contributions were made in full. The recent performance of the stock market has effected the Unfunded Actuarial Accrued Liabilities ("UAAL") of SCERS. It is not known whether employer contributions will be necessary in the foreseeable future to fund a portion of SCERS' UAAL.

Actuarial Data

Valuation date	January 1, 2002
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period	33.7 years
Amortization period	Open
Asset valuation method	Market

Actuarial Assumptions*

	Percentage
Investment rate of return	8.00%
Projected general wage increases	4.50
Cost-of-living year-end bonus dividend	0.67

* Includes price inflation at 4.0%.

Schedule of funding progress for the City (dollar amounts in millions):

Actuarial Valuation Date January 1, ⁽⁵⁾	Actuarial Value of Assets (a)	Actuarial Accrued Liabilities ("AAL") Entry Age ⁽¹⁾ (b)	Unfunded AAL ("UAAL") ⁽²⁾ (b-a)	Funding Ratio (a/b)	Covered Payroll ⁽³⁾ (c)	UAAL or Excess as a Percentage of Covered Payroll ((b-a)/c)
2000	\$1,582.7	\$1,403.1	\$(179.6)	112.8 %	\$370.4	(48.5)%
2001 ⁽⁴⁾	1,493.1	1,490.3	(2.8)	100.2	405.0	(.7)
2002	1,383.7	1,581.4	197.7	87.5	405.1	48.8

⁽¹⁾ Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.

⁽²⁾ Actuarial accrued liabilities less actuarial value of assets; funding excess if negative.

⁽³⁾ Covered payroll includes compensation paid to all active employees on which contributions are calculated.

⁽⁴⁾ Information for January 1, 2001, was provided by an actuarial study, rather than a full valuation.

⁽⁵⁾ Actuarial valuation information for January 1, 2003, is not available. Actuarial valuations will be performed every two years and the next regular valuation will be as of January 1, 2004.

8. DEFERRED COMPENSATION

The Department's employees may contribute to the City's Voluntary Deferred Compensation Plan (the "Plan"). The Plan, available to City employees and officers, permits participants to defer a portion of their salary until future years. The Plan administrator was Fidelity Investments in 2003 and 2002. The deferred compensation is paid to participants and their beneficiaries upon termination, retirement, death, or unforeseeable emergency.

Effective January 1, 1999, the Plan became an eligible deferred compensation plan under Section 457 of the IRC of 1986, as amended, and a trust exempt from tax under IRC Sections 457(g) and 501(a). The Plan is operated for the exclusive benefit of participants and their beneficiaries. No part of the corpus or income of the Plan shall revert to the City or be used for, or diverted to, purposes other than the exclusive benefit of participants and their beneficiaries.

The Plan is not reported in the financial statements of the City or the Department.

It is the opinion of the City's legal counsel that the City has no liability for investment losses under the Plan. Participants direct the investment of their money into one or more options provided by the Plan and may change their selection from time to time. By enrolling in the Plan, participants accept and assume all risks inherent in the Plan and its administration.

9. LONG-TERM PURCHASED POWER, EXCHANGES, AND TRANSMISSION

Bonneville Power Administration—The Department purchases electric energy from the U.S. Department of Energy, Bonneville Power Administration ("Bonneville") under the Block and Slice Power Sales Agreement, a 10-year contract that expires September 30, 2011. The agreement provides a block of power shaped to the Department's monthly net requirements, defined as the difference between projected monthly load and firm resources available to serve that load. Additional amounts of power will be purchased and received throughout the term of the contract under the Slice portion of the contract. The terms of the Slice product specify that the Department will receive a fixed percentage (4.6676%) of the actual output of the Federal Columbia River Power System. The cost of Slice power is based on the Department's same percentage (4.6676%) of the expected costs of the system and is subject to true-up adjustments based on actual costs. The true-up adjustment billed by Bonneville for federal fiscal year 2002 was \$10.4 million and was deferred pending rate recovery of the amount due and \$8.5 million was amortized in 2003; a true-up credit of \$6.3 million for federal fiscal year 2003 was deferred as of December 31, 2003, and will be recognized during 2004. Bonneville rate adjustments will be passed through to retail electric customers in the form of rate adjustments in accordance with the rates ordinance. The actual amounts of firm and nonfirm energy available through the Slice product will vary with water conditions, federal generating capabilities, and fish and

wildlife restoration requirements, and expected amounts available under critical water conditions in average megawatts (“aMW”) are as follows:

	Block Power ⁽¹⁾ aMW	Slice Power ⁽²⁾ aMW
2004	137	334
2005	146	334
2006	184	334
2007 - 2010	260	334
2011	170	334

⁽¹⁾ Amendment No. 6, Bonneville Block Power, September 2003.

⁽²⁾ Slice power expected in critical water conditions.

Amendments to the contract through September 2003 provide that Bonneville will pay the Department for energy savings through specified programs. The conservation augmentation program provides funding from Bonneville for a portion of the Department’s conservation costs in exchange for a reduction of the amount of power, by the amount of energy saved, that the Department will purchase from Bonneville. The conservation and renewables discount (“C&RD”) program provides a Bonneville power bill credit for qualifying conservation, renewables, and low-income weatherization costs, and donations to qualifying organizations.

Information related to the programs is summarized as follows:

Contract Year	Conservation Augmentation ⁽¹⁾		C&RD	
	Estimated Energy Savings (aMW)	Cash Receipts (Millions)	Revenues (Millions)	Revenues (Millions)
2002	8.46	\$20.0	\$3.3	\$2.1
2003	8.75 ⁽²⁾	10.7	3.4	2.1
2004	7.76	8.6		
2005 – 2006	7.25	12.2		

⁽¹⁾ Cash receipts are being recognized over the life of the Bonneville contract. Revenues for 2002 included \$0.7 million for 2001.

⁽²⁾ Energy savings for 2003 have been submitted to Bonneville for audit.

Energy Northwest—In 1983, the Department entered into separate net billing agreements with Bonneville and Energy Northwest (formerly the Washington Public Power Supply System), a municipal corporation and joint operating agency of the state of Washington, with respect to sharing costs for the construction and operation of three nuclear generating plants. Under these agreements, the Department is unconditionally obligated to pay Energy Northwest a pro rata share of the total annual costs, including debt service, decommissioning costs, and asset retirement obligations, to finance the cost of construction, whether or not construction is completed, delayed, or terminated, or operation is suspended or curtailed. The net billing agreements provide that these costs be recovered through Bonneville rates. The Department pays the amounts billed by Bonneville directly to Energy Northwest until the payment obligation has been fulfilled for the year. The billings for the remainder of the year are then paid to Bonneville. One plant is in commercial operation. Construction of the other two plants has been terminated.

Lucky Peak—In 1984, the Department entered into a purchase power agreement with four irrigation districts to acquire 100% of the net output of a hydroelectric facility that began commercial operation in 1988 at the existing Army Corps of Engineers Lucky Peak Dam on the Boise River near Boise, Idaho. The irrigation districts are owners and license holders of the project, and the FERC license expires in 2030. The agreement, which expires in 2038, obligates the Department to pay all ownership and operating costs, including debt service, over the term of the contract, whether or not the plant is operating or operable.

To properly reflect its rights and obligations under this agreement, the Department includes as an asset and liability the outstanding principal of the project’s debt, net of the balance in the project’s reserve account. In July 2002, the project issued revenue refunding bonds totaling \$55.985 million that bear interest ranging from 3.0% to 5.0% and mature July 1, 2004 through 2008.

British Columbia-Ross Dam—In 1984, an agreement was reached between the Province of British Columbia and the City under which British Columbia will provide the Department with power equivalent to that which would result from an addition to the height of Ross Dam. The agreement was ratified through a treaty between Canada

and the United States in the same year. The power is to be received for 80 years, and delivery of power began in 1986. The Department will make annual payments to British Columbia of \$21.8 million through 2020, which represent the estimated debt service costs the Department would have incurred had the addition been constructed. The payments are charged to expense over a period of 50 years through 2035. The Department is also paying equivalent operation and maintenance costs. Payments made for this purpose totaled \$164,181 and \$163,997 in 2003 and 2002, respectively.

In addition to the direct costs of power under the agreement, the Department incurred costs of approximately \$8.0 million in prior years related to the proposed addition and was obligated to help fund the Skagit Environmental Endowment Commission through four annual \$1.0 million payments. These costs were deferred and are being amortized to purchased power expense over 35 years.

Klamath Falls—In November 2000, the Department and the City of Klamath Falls, Oregon, entered into an agreement for the purchase of energy and capacity from the Klamath Falls generation facility, a 500-MW plant consisting of two combustion turbines fueled by natural gas. Under the terms of the contract, the Department receives 100.0 MW of capacity from the project beginning on the project's date of commercial operation of July 29, 2001, through July 31, 2006, with an option to renew the contract for an additional five years. The Department may elect to displace all or a portion of the energy it is entitled to receive from this project in any given month and elected to take power from the plant for nine months in 2003 and 10 months in 2002. The Department assumes gas price and exchange rate risks for natural gas from Alberta, Canada. In April 2001, the Department entered into a separate contract that expired in December 2002 to swap variable Canadian dollar gas prices for a fixed U.S. dollar gas price, and recognized \$12.3 million expenses in 2002.

Wind Generation—In October 2001, the Department entered into an agreement with PacifiCorp Power Marketing, Inc. (now PPM Energy) for the purchase of energy and associated environmental attributes

primarily from the State Line Wind Project, a 300 MW facility located in Walla Walla County, Washington, and Umatilla County, Oregon. The aggregate maximum delivery rate per hour was 50 MW from January 1, 2002, through July 31, 2002, increasing to 100 MW from August 1, 2002, through December 31, 2021. The Department will also receive additional firm energy with an aggregate maximum delivery rate per hour of 50 MW from January 1, 2004, through June 30, 2004, and an additional 75 MW from July 1, 2004, through December 31, 2021, from the State Line Wind Project.

The Department entered into a related 10-year agreement to purchase integration and exchange services from PacifiCorp. PacifiCorp receives State Line Wind Project energy at the Wallula Substation in Walla Walla County, Washington, and stores, reshapes, and delivers the power two months later. The Department also entered into another related 20-year agreement to sell integration and exchange services to PPM Energy only when the Department does not receive 50 MW of contractually defined additional energy from the State Line Wind Project.

Other Long-Term Purchased Power Agreements—The Department also purchases energy from Public Utility Districts (the "PUDs") No. 1 of Pend Oreille County and No. 2 of Grant County, under agreements expiring August 1, 2005, and October 31, 2005, respectively; the Grand Coulee Project Hydroelectric Authority (the "GCPH Authority"), which includes the South, East, and Quincy Columbia Basin Irrigation Districts under 40-year agreements that expire from 2022 to 2026; the Department purchased power from the Columbia Storage Power Exchange until the agreement expired on March 31, 2003. Rates under the Grant County PUD and GCPH Authority contracts represent the share of the operating and debt service costs in proportion to the share of total energy to which the Department is entitled, whether or not these plants are operating or operable.

Three new contracts were executed in March 2002 with Grant County PUD to replace the contract expiring October 31, 2005. The agreements are effective November 1, 2005, and run concurrent with the term of the future federal relicense period.

Power received under long-term purchased power agreements in average annual megawatts ("aaMW") is as follows:

Long-Term Purchased Power	2003 aaMW	Percent of Total	2002 aaMW	Percent of Total
Bonneville Slice	390.9	50.1%	379.6	48.9%
Bonneville Block	147.1	18.8%	152.3	19.6%
Lucky Peak	33.4	4.3%	33.0	4.2%
British Columbia—Ross Dam	36.0	4.6%	33.9	4.4%
City of Klamath Falls	74.7	9.6%	81.0	10.4%
Wind generation	24.7	3.2%	12.2	1.6%
Pend Oreille County Public Utility District	5.4	0.7%	5.0	0.6%
Grant County Public Utility District	35.5	4.5%	37.3	4.8%
Grand Coulee Project Hydroelectric Authority	26.9	3.4%	28.3	3.6%
Columbia Storage Power Exchange	3.0	0.4%	11.3	1.5%
	70.8	9.0%	81.9	10.5%
	777.6	99.6%	773.9	99.6%
Other	3.2	0.4%	2.8	0.4%
	780.8	100.0%	776.7	100.0%
Peaking Capacity British Columbia—Ross Dam	130.0		141.0	

Transmission—In July 2000, the Department entered into an agreement with Bonneville for firm transmission service under Bonneville's open access transmission tariff from August 2000 through July 2025. In September 1994, the Department entered into an agreement with Bonneville for ownership of 160 MW of Bonneville's Pacific Northwest north-south AC Intertie for \$34.3 million and annual operations costs. Other transmission contracts were executed in 1995 with Puget Sound Energy for transmission of

South Fork Tolt power through 2020; in 1988 with Idaho Power for transmission of Lucky Peak power through December 2007; in 1983 with GCPH Authority for transmission of the output of the GCPH Authority's power plants over the 40-year terms of several related power contracts; and in 1983 as amended in 1990 with Avista for transmission of the power output of the Summer Falls and Main Canal projects through October 2005.

Estimated Future Payments Under Purchased Power And Transmission Contracts—The Department's estimated payments under its contracts with Bonneville, the PUDs, irrigation districts, Lucky Peak Project, British Columbia - Ross Dam, Klamath Falls, PPMI and PacifiCorp for wind energy and net integration and exchange services, and for transmission for the period from 2004 through 2065, undiscounted, are:

Year Ending December 31,	Estimated Payments
2004	\$ 275,405,308
2005	284,191,348
2006	283,463,321
2007	280,518,410
2008	280,447,450
2009 – 2013 ⁽¹⁾	927,524,568
2014 – 2018	474,569,397
2019 – 2023	378,175,606
2024 – 2028 ⁽²⁾	121,453,263
2029 – 2033	27,453,994
2034 – 2038	15,533,661
2039 – 2065 ⁽³⁾	4,504,416
	\$3,353,240,742

⁽¹⁾ Bonneville Block and Slice contract expires September 30, 2011.

⁽²⁾ Bonneville transmission contract expires July 31, 2025.

⁽³⁾ BC Hydro—Ross Dam operations and maintenance costs estimated at \$166,830 per year from 2039 to 2065.

The effects of a proposed Regional Transmission Organization and other changes that could occur to transmission as a result of FERC's proposed Standard Market Design are not reflected in the estimated future payments.

Payments under these long-term power contracts totaled \$251.8 million and \$238.2 million in 2003 and 2002, respectively. Payments under these transmission contracts totaled \$30.0 million and \$30.7 million in 2003 and 2002, respectively.

Power Exchanges—Northern California Power Agency ("NCPA") and the Department executed a long-term Capacity and Energy Exchange Agreement in March 1993. NCPA provides a total of 91,584 MWh, or an option of 108,696 MWh under conditions specified in the contract, of exchange power to the Department from December through April. The Department provides a total of 90,580 MWh of exchange power to NCPA from June through October 15. The agreement may be terminated in May 2014 with seven years advance written notice by either party.

The Tacoma-Seattle Energy Coordination and Exchange Agreement was executed in October 1991. The Agreement provided for the firm exchange of 50 average megawatts of energy from Tacoma to Seattle each August and from Seattle to Tacoma each October until expiration in October 2003.

10. OTHER ASSETS

Other assets comprise deferred energy management costs and other deferred charges. Deferred energy management costs-net represent programmatic conservation costs. Seattle City Council-passed resolutions authorize the debt financing and deferral of programmatic conservation costs not funded by third parties and incurred by the Department. These costs are to be recovered through rates over 20 years.

Deferred power costs incurred for short-term wholesale power purchases during 2001 are expected to be recovered through rates at \$8.3 million per month through 2004, pursuant to SFAS No. 71 and Ordinance 120385.

Other deferred charges and assets-net consist of the following at December 31:

	2003	2002
Unrealized losses from fair valuations of:		
Short-term forward sales of electric energy	\$ -	\$ 3,935,769
Short-term forward purchases of electric energy	163,664	
BPA Slice contract true-up payment	1,898,666	10,442,663
British Columbia—Ross Dam	40,321,500	31,448,059
Puget Sound Energy interconnection and substation	1,862,370	2,005,283
Studies, surveys, and investigations	533,435	406,808
Skagit Environmental Endowment	1,997,712	2,115,225
Endangered Species Act	1,341,435	
Real estate and conservation loans receivable	473,169	657,441
Unamortized debt expense	5,315,921	4,461,726
General work in process to be billed	1,035,352	1,036,565
Other	1,349,997	153,596
	\$56,293,221	\$56,663,135

Unamortized charges for the deferral of debt payments relating to Ross Dam will be amortized between 2021 and 2035. The remaining components of other assets, excluding billable work in progress, are being amortized to expense over four to 36 years.

11. DEFERRED CREDITS

Deferred credits consists of the following at December 31:

	2003	2002
BPA conservation augmentation	\$24,200,537	\$16,663,356
BPA Slice true-up	6,348,625	
Unrealized gains from fair valuation of short-term forward sales of electric energy	2,115,376	396,168
Levelized lease payments for Seattle office	919,404	947,360
Prepaid capital fees	1,420,338	1,732,238
Customer deposits—sundry sales	1,107,614	1,070,531
Prepaid grants	571,624	164,785
Other	286,691	242,274
	\$36,970,209	\$21,216,712

12. PROVISION FOR INJURIES AND DAMAGES

The Department is self-insured for casualty losses to its property, including for terrorism, environmental cleanup, and certain losses arising from third-party damage claims. The Department establishes liabilities for claims based on estimates of the ultimate cost of claims. The length of time for which such costs must be estimated varies depending on the nature of the claim. Actual claims costs depend on such factors as inflation, changes in doctrines of legal liability, damage awards, and specific incremental claim adjustment expenses. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which reflect recent settlements, claim frequency, industry averages, City-wide cost allocations, and economic and social factors. Liabilities for lawsuits, claims, and workers' compensation were discounted over a period of 15 to 17 years in 2003 and 2002 at the City's average annual rate of return on investments, which was 3.161% in 2003 and 4.238% in 2002. Liabilities for environmental cleanup and for casualty losses to the Department's property do not include claims that have been incurred but not reported and are not discounted due to uncertainty with respect to regulatory requirements and settlement dates, respectively.

The Lower Duwamish Waterway was designated a federal Superfund site by the EPA in 2001 for contaminated sediments. The City of Seattle is one of four parties who signed an Administrative Order on Consent with the EPA and State Department of Ecology to conduct a remedial investigation/feasibility study to prepare a site remedy. The Department is considered a potentially responsible party for contamination in the Duwamish River due to land ownership or use of property located along the river. The estimated liabilities related to this site totaled \$5.7 million and \$2.5 million for 2003 and 2002, respectively.

The schedule below presents the changes in the provision for injuries and damages:

	2003	2002
Unpaid claims at January 1	\$10,476,242	\$ 8,090,816
Payments	(2,391,275)	(1,474,499)
Incurred claims	5,572,574	3,859,925
Unpaid claims at December 31	\$13,657,541	\$10,476,242

The provision for injuries and damages is included in current and noncurrent liabilities as follows:

	2003	2002
Noncurrent liabilities	\$10,491,426	\$ 7,895,490
Accounts payable and other	3,166,115	2,580,752
	\$13,657,541	\$10,476,242

13. COMMITMENTS AND CONTINGENCIES

Operating Leases—In December 1994, the City entered into an agreement on behalf of the Department for a 10-year lease of office facilities in downtown Seattle commencing February 1, 1996. In early 1996, the City purchased the building in which these facilities are located, thus becoming the Department's lessor. In addition, the Department leases equipment and smaller facilities for office and storage purposes through long-term operating lease agreements. Expense under the leases totaled \$3.8 million and \$3.5 million in 2003 and 2002, respectively.

Minimum payments under the operating leases are:

Year Ending December 31	Minimum Payments
2004	\$3,797,985
2005	3,809,334
2006	511,079
2007	113,588
2008	84,078
2009	1,360
	\$8,317,424

Skagit Mitigation—In 1995, FERC issued a license for operation of the Skagit Project in effect through 2025. As a condition of the license, the Department has taken and will continue to take various mitigating actions relating to fisheries, wildlife, erosion control, archeology, historic preservation, recreation, and visual quality issues. The mitigation cost was estimated at December 31, 2003, to be \$47.7 million, of which \$45.0 million has been expended.

2004 Program—The estimated financial requirement for the Department's 2004 capital improvement and conservation program is \$130.4 million, and the Department has substantial contractual commitments relating thereto.

Project Impact Payments—Effective November 1999, the Department committed to pay a total of \$11.6 million and \$7.8 million over 10 years ending in 2008 to Pend Oreille County and Whatcom County, respectively, for impacts on county governments from the operations of the Department's hydroelectric projects. The payments compensate the counties, and certain school districts and towns located in these counties, for loss of revenues and additional financial burdens associated with the projects. The Boundary Project located on the Pend Oreille River affects Pend Oreille County, and Skagit River hydroelectric projects affect Whatcom County. The combined impact compensation, including annual inflation factor of 3.1%, and retroactive payments totaled \$1.1 million to Pend Oreille County in each year and \$0.7 million and \$0.8 million to Whatcom County in 2003 and 2002, respectively.

Endangered Species—Several fish species that inhabit waters where hydroelectric projects are owned by the Department or where the Department purchases power have been listed under the Endangered Species Act as threatened or endangered. On the Columbia River system, the National Oceanographic Atmospheric Administration Fisheries has developed a broad species recovery plan for listed salmon and steelhead, including recommendations for upstream and downstream fish passage requirements. These requirements include minimum flow targets for the entire Columbia Basin designed to maximize the survival of migrating salmon and steelhead. As a result, the Department's power generation at its Boundary Project is reduced in the fall and winter when the region experiences its highest sustained energy demand. The Boundary Project's firm

capability is also reduced. Other Department-owned projects are not affected by the Columbia River. In Puget Sound, both bull trout and chinook salmon have been listed as threatened. Bull trout are present in the waters of Skagit, Tolt, and Cedar River projects and chinook salmon occur downstream. While it is unknown how other listings will affect the Department's hydroelectric projects and operations, the Department is carrying out an ESA Early Action program in cooperation with agencies, tribes, local governments, and salmon groups that will assist in the recovery of bull trout and chinook salmon on the Skagit and Tolt. On the Cedar, the Department's activities are covered by a Habitat Conservation Plan that authorizes operations with regard to all listed species. Hydroelectric projects must also satisfy the requirements of the Clean Water Act in order to obtain a FERC license. The application for the new boundary license is due October 2009 and may entail additional requirements for endangered species for which the full extent is not known at this time.

Streetlight Litigation—In November 2003, the Washington Supreme Court ruled that a 1999 ordinance related to inclusion of streetlight costs in the general rate base for Seattle customers was unlawful. As a result of this decision, the Department resumed billing the City of Seattle for streetlight costs. At December 31, 2003, the remedies phase of this case was still being litigated. On May 21, 2004, trial court proceedings resulted in a ruling that the Department be required to refund the amount collected from ratepayers since 2000 attributable to streetlight costs. However, the ruling also provides that the City of Seattle general fund will have to repay the Department for the streetlight bills that would have been sent over the same period. Apart from the administrative costs that may be involved, the Department does not believe that the court's order will result in a negative impact to the Department's financial position or operations; however, the case is subject to appeal, which could change these trial court rulings.

Other Contingencies—In the normal course of business, the Department has various other legal claims and contingent matters outstanding. The Department believes that any ultimate liability arising from these actions will not have a material adverse impact on the Department's financial position or operations.